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No. 86-751

In the Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether 661,000 shares of common stock of a bank that petitioner sold in 1975 were "capital assets" as defined in Section 1221 of the Internal Revenue Code, with the result that the loss realized by petitioner on the sale of the stock was not an ordinary loss, but rather was a capital loss subject to limited deductibility under Section 165(f) of the Code.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A12) is reported at 800 F.2d 215. The opinion of the Tax Court (Pet. App. B1-B28) is reported at 83 T.C. 640.

JURISDICTION

The judgment of the court of appeals (J.A. 23) was entered on September 9, 1986. The petition for a writ of certiorari was filed on November 7, 1986, and was granted on March 23, 1987 (J.A. 24). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 1221 of the Internal Revenue Code (26 U.S.C.) provides:

Capital asset defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer

(whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by—

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).

STATEMENT

1. Petitioner is a diversified holding company. It was organized in 1966 to hold all of the stock of Arkansas Best Freight System, Inc., a successful trucking line operating in the Midwest. Petitioner immediately embarked upon an expansion program with the plan of becoming a conglomerate. It acquired all of the stock of various corporations engaged in furniture manufacturing, insurance, data processing, used tire retreading, and new tire sales. The tire subsidiary also held the real estate occupied by petitioner and its subsidiaries. Petitioner provided financial planning and, in some cases, accounting and personnel services to its subsidiaries, and they in turn paid a management fee to it. The subsidiaries often acted as suppliers or customers for one another, and they generally interacted in a synergistic fashion. Pet. App. A2, B3-B4, B19; J.A. 2-3.

From 1966, the year of petitioner's organization, until 1973, Robert A. Young, Jr. served as Chairman of petitioner's Board of Directors. Between March 1967 and April 1968, Young personally acquired 209,000 shares of the common stock of the National Bank of Commerce of Dallas, Texas (the Bank), as well as rights to buy additional Bank shares. These shares and rights were transferred to petitioner in June 1968. As a result of these transactions, and of petitioner's purchase of additional Bank shares later that year, petitioner at the end of 1968 owned 266,614 shares of the Bank's common stock, or 64.97% of the then-outstanding common shares. Pet. App. A2, B4-B5; J.A. 4-8.

At the time petitioner acquired the Bank shares, it was aware of pending legislation concerning bank holding companies that, if enacted, would substantially affect corporations that acquired, or had acquired, controlling interests in banks. Petitioner had called a special meeting of its shareholders to consider the proposed acquisition of Bank stock. Petitioner informed them in a proxy statement that enactment of the pending legislation would cause it to be classified as a "bank holding company" if it acquired the Bank shares, and might require it, as such, to divest itself of voting shares of companies that were not banks or bank holding companies. Pet. App. B5-B6.

On the other hand, petitioner also informed its shareholders that there were good reasons for acquiring the Bank stock. Petitioner had obtained disinterested appraisals of the Bank stock and projections of the Bank's expected growth and earnings, which suggested that the acquisition would be a good investment. Dallas at the time was developing rapidly as a

financial center, and banks were at the center of the boom, so it seemed likely that the Bank shares would appreciate in value. Moreover, petitioner was planning a public offering of its own shares and believed that its financial statements would be rendered more attractive by virtue of ownership of the Bank stock. The acquisition was also expected to yield favorable results in other respects, including improved price/earnings ratios, enhanced prestige and access to financing in the financial community, and some protection from hostile takeover attempts. Pet. App. B5-B6; J.A. 8-9.

After the acquisition, the Bank did not interact with petitioner and its subsidiaries in the same synergistic fashion as did the other subsidiaries. The Bank offered no financing to the corporate group and, as was typical of banks, it contributed little by way of earnings distributions. Petitioner supplied no management services to the Bank, and the Bank did not pay it any management fees. At no time did petitioner have more than three representatives on the Bank's board of directors, which averaged 20 members. Pet. App. B7.

In December 1970, Congress enacted the Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760. Pursuant to this new statute, petitioner was classified as a bank holding company and was required either to cease making acquisitions of non-bank businesses or to divest itself of control of the Bank. See 12 U.S.C. 1841(a). Petitioner chose the latter alternative. On July 30, 1971, petitioner filed with the Federal Reserve Bank of Dallas an irrevocable declaration that it would divest itself of control of the Bank by January 1, 1981. J.A. 10. Petitioner was then free to make further

acquisitions of non-bank businesses, and it proceeded to do so. Pet. App. B7; J.A. 10-11.

Between 1969 and 1974, petitioner acquired 585,795 additional Bank shares by means of various purchases, stock dividends, conversions, and responses to capital calls. These acquisitions served to increase petitioner's holdings to 852,409 shares, or 65.77% of the common shares then outstanding. Thus, although petitioner more than tripled the number of shares that it owned during this period, its percentage interest in the Bank remained substantially the same, increasing by only 0.8%. Pet. App. B8-B9.[1]

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[1] The Tax Court listed petitioner's acquisitions of Bank shares during 1969-1974 as follows (Pet. App. B9; see J.A. 9-12):

Year	*Number of shares acquired*	*Transaction*
1969	142,670	Two capital calls
1969	24,188	Purchase
1971	43,347	Stock dividend
1972	19,072	Stock dividend
1972	95,363	Capital call
1972	6,165	Purchase
1973	23,902	Stock dividend
1973	103,887	Capital call
1973	135	Purchase
1974	124,664	Conversion of $3,116,610 principal amount of convertible debentures, which had been acquired in 1973 on capital call
1974	2,402	Purchase
Total	585,795	

Some of the listed transactions that the Tax Court referred to as capital calls were referred to in a stipulation of facts submitted by the parties as exercises of stockholder preemptive rights (J.A. 9, ¶ 20). Presumably, when added capi-

The capital calls made by the Bank during 1969-1974 reflected the concerns of federal regulators that the Bank was inadequately capitalized. From 1968 until 1972 the Bank appeared to be successful and growing, and the capital calls during that time were designed to accommodate its growth. In 1972, however, after petitioner had commenced negotiations with Texas Commerce Bancshares (TCB) to divest itself of the Bank shares on favorable terms in a stock-for-stock transaction, TCB's representatives examined the Bank's loan portfolio and discovered serious problems. TCB thereupon withdrew from the negotiations. Subsequently, federal examiners undertook their own examination and classified the Bank as a problem bank, primarily because it had a heavy concentration of loans in the Dallas real estate business, which suffered a severe collapse at about that time. Pet. App. A2-A3, B9-B10.

The capital calls issued by the Bank after 1972 were in response to these loan-portfolio problems. Petitioner responded to the capital calls for a number of reasons. First, participation of the majority shareholder was essential to save the Bank, and thus petitioner was compelled to participate if it wished to preserve its equity stake. Second, failure to participate, with the resultant demise of the Bank, likely would have exposed petitioner to litigation by minority shareholders. Third, permitting the Bank to fail

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tal was required, shares were offered to existing shareholders on a pro-rata basis. Presumably, also, the stock dividends served the purpose of increasing capital by capitalizing earnings. That would explain why, although petitioner more than tripled the number of shares that it owned during this period, its percentage ownership increased only from 64.97% to 65.77%.

would reflect badly on petitioner so that its sources of financing might be jeopardized and its reputation for skilled management might be tarnished. Pet. App. B10-B11.[2]

Notwithstanding the Bank's problems, petitioner still hoped, at least as late as July 1974, to dispose of its Bank stock at a profit, and it apparently expected capital-gain treatment on such a profitable sale. At a meeting of petitioner's board of directors in that month, its general counsel reviewed the possible tax treatment of a bank stock divestiture. He expressed the hope that, pursuant to pending legislation, the anticipated capital gain could be spread over a ten-year period, or, alternatively, that the proceeds of sale could be invested in a new asset and that taxation of the capital gain could be delayed until the disposition of the new asset. Pet. App. B10. Throughout the period in question, petitioner referred to the Bank stock as an "investment" in its financial records and other corporate documents (Pet. App. B7; Exhs. Q1-Q8).[3]

On June 30, 1975, petitioner sold to a group of investors 661,000 shares of Bank stock, representing 51% of the outstanding common stock, leaving peti-

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[2] The existence of these three reasons was a finding of fact made by the Tax Court (Pet. App. B10-B11). In its opinion, however, the Tax Court made the somewhat contradictory statement that the post-1972 acquisitions were "solely to preserve [petitioner's] business reputation" (*id.* at B21).

[3] At petitioner's annual stockholders' meeting in May 1974, the Chairman of the Board noted that "the Bank is an investment for us" and stated that petitioner expected a substantial profit upon the sale of the Bank stock (Exh. P(AC), at 10, 11). In addition, petitioner listed the Bank stock under "Investments" on its federal income tax returns for 1970-1975 (Exhs. 2B, 3C, 4D, 5E, 6F, 7G).

tioner with a 14.7% stake. For the 661,000 shares sold, petitioner received cash and a note, secured by the shares sold, with an aggregate value in excess of $5.9 million (Pet. App. B11; J.A. 13, ¶ 30(b)). Petitioner's cost or "basis" in the 661,000 shares was about $15 million (J.A. 4, ¶ 7).

On a consolidated federal income tax return filed on behalf of itself and its subsidiaries for 1975, petitioner claimed a deduction for an ordinary loss in the amount of $9,995,688 from the sale of the 661,000 shares of Bank stock. In his notice of deficiencies, the Commissioner disallowed the claimed ordinary-loss deduction, finding that the loss resulting from the sale was a capital loss, subject to the limitations of Sections 165(f) and 1211(a) of the Internal Revenue Code.[4] Those Sections generally provide that a corporate taxpayer may deduct capital losses only to the extent of its capital gains, while permitting excess capital losses to be carried over to other years.

2. Petitioner sought redetermination of the asserted deficiencies in the Tax Court. The Tax Court agreed with the Commissioner that the Bank shares acquired by petitioner before the end of 1972 were capital assets whose disposition gave rise to a capital loss. But the court held that the Bank shares acquired by petitioner after 1972, with the exception of one minor acquisition,[5] were non-capital assets whose

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[4] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

[5] The court held that 2,402 shares acquired by petitioner from Universal Insurance Co. (UIC) were a capital asset. The court assumed that UIC was not a subsidiary of petitioner at the time (Pet. App. B21), and hence reasoned that petitioner's purchase from UIC could not have served the

disposition gave rise to an ordinary loss. In so holding, the Tax Court took as its points of departure its own previous opinion in *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694, 712 (1976), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977), and the Court of Claims' opinion in *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (1962). Those two decisions had interpreted this Court's opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955), to support the conclusion that securities disposed of by a taxpayer should be treated as a non-capital asset if the securities transaction is sufficiently related to the taxpayer's trade or business. The Tax Court framed the issue based on *Booth Newspapers* as whether "petitioner purchased and held the stock of [the Bank] as an integral and necessary act in the conduct of [petitioner's] business or whether the stock was purchased and held with an investment purpose" (Pet. App. B16). The court further noted that, under its decision in *W.W. Windle*, " 'stock purchased with a substantial investment purpose is a capital asset even if there is a more substantial business motive for the purchase' " (*id.* at B17 (quoting 65 T.C. at 712)).

The Tax Court did not find that the purchase and holding of Bank stock was "an integral and neces-

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business purpose of protecting a subsidiary from regulatory sanctions. We agree with petitioner (see Pet. Br. 7 n.4) that this portion of the Tax Court's opinion rests on an erroneous factual premise; the parties stipulated (Exh. 1A) that UIC was already a subsidiary of petitioner at the time of the purchase in question. We nevertheless believe, of course, that the court of appeals correctly held that all 661,000 Bank shares sold in 1975, including the 2,402 purchased from UIC, were capital assets.

sary act" in the conduct of petitioner's business or that of its subsidiaries; instead, the court extended the *Booth Newspapers* rationale to the facts of this case. The Tax Court asserted, in apparent conflict with its findings of fact (see Pet. App. B5-B6), that most of petitioner's acquisitions of Bank shares after 1972 "were made exclusively for business purposes and subsequently held for the same reasons" (Pet. App. B20). The court noted in this connection that the purchases were designed "to preserve [petitioner's] business reputation" and that expenditures for such a purpose are typically deductible as business expenses (*id.* at B20-B21). The court on that basis concluded that these shares were non-capital assets, the sale of which gave rise to an ordinary loss (*ibid.*). With respect to petitioner's acquisitions of Bank stock during 1968-1972, by contrast, the Tax Court concluded that the acquisitions "were motivated primarily by investment purpose" and therefore constituted capital assets giving rise to a capital loss when sold in 1975 (*id.* at B18, B19).

3. The Commissioner appealed with respect to the Tax Court's holding that most of the Bank shares acquired after 1972 were ordinary assets. Petitioner cross-appealed with respect to the Tax Court's holding that the shares acquired between July 30, 1971, and December 31, 1972, were capital assets.[6] The court of appeals, by a 2-1 vote, held in favor of the Commissioner, reversing "insofar as the Tax

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[6] Petitioner therefore abandoned on appeal the claim it had pressed in the Tax Court for ordinary-loss treatment for the Bank shares acquired between June 1968 and July 30, 1971, the date it filed its irrevocable divestment election with the Dallas Federal Reserve Bank.

Court allowed ordinary loss treatment for any of the capital stock transactions" (Pet. App. A2), but affirming the Tax Court's decision in all other respects (*id.* at A1-A11).

The court of appeals concluded that all of petitioner's shares of Bank stock fell within the definition of "capital asset" set forth in Section 1221 of the Code. That Section defines a "capital asset" as "property held by the taxpayer (whether or not connected with his trade or business)," with five specific exceptions. The court concluded that the Bank shares satisfied the general definition in Section 1221 and, as petitioner conceded, did not fall within any of the five exceptions. Pet. App. A4-A8. The court of appeals acknowledged that some courts, including the Court of Claims in *Booth Newspapers*, had "taken the position that capital stock is not a capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business" (*id.* at A8; see *id.* at A8-A10 (citing cases)). But the court expressly rejected these decisions, characterizing them as "misbegotten" (*id.* at A10) and noting that they "lack a basis in the statutory language" (*id.* at A9). Dismissing petitioner's contention that these decisions simply applied a judicial exception supposedly created by this Court's *Corn Products* opinion, the court below emphasized that it "d[id] not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221" (*id.* at A10).[7]

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[7] In this regard, the court of appeals was not speaking of securities held as inventory by a securities dealer; it had earlier noted (Pet. App. A5) that such securities would be

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioner candidly acknowledges that the 661,000 shares of Bank stock it sold in 1975 fall within the statutory definition of "capital asset" contained in Section 1221 of the Code. Petitioner thus concedes that the loss it realized on the sale of those shares would give rise to a capital loss "based on the statutory language alone" (Br. 12). Petitioner nevertheless contends that a substantial portion of these shares—those acquired after July 30, 1971—should be treated as non-capital assets whose sale gave rise to an ordinary loss.

In making this contention, petitioner relies on a supposed extra-statutory exception to Section 1221's definition of "capital asset." Petitioner characterizes this supposed exception, which would be an addition to the five exceptions listed in the statute, as an "improvement[ ]" (Br. 35) worked by "judicial craftsmen" (Br. 34) upon the statutory definition—a definition that petitioner describes as a "statutory strait jacket" and "a rough Congressional tool whose imperfections were obvious" (Br. 21, 34). Petitioner asserts that this judge-made improvement was necessary to "effectuate the intent of Congress" (Br. 20) by "distinguish[ing] between assets acquired and held in connection with the taxpayer's usual trade or business and those acquired principally for investment" (Br. 11). Based on this theory, petitioner asserts that any asset acquired for "a dominant business motive" (Br. 43) is not a capital asset. And petitioner maintains that this amendment to the statutory definition was accompiished by this Court's

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excluded from the definition of a "capital asset" under the exception for "inventory" set forth in Section 1221(1).

opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955), which on petitioner's view "cannot be reconciled" (Br. 11) with the decision below treating the Bank shares as capital assets. Each step of petitioner's argument is wrong.

First, as petitioner admits, the rule that it seeks to apply here cannot be squared with the language of the statute. That fact alone is dispositive of petitioner's contention. An inquiry into legislative intent is an aid to interpreting a statute, but it cannot provide a basis for ignoring the statute's language.

Second, petitioner's description of Congress's intent is mistaken in any event. Petitioner adduces no evidence to support its view that Congress intended in enacting Section 1221 to exclude all business-related assets from the definition of "capital asset." The language of the statute is surely hostile to that view: in defining "capital asset" as property held by the taxpayer "whether or not connected with his trade or business," the statute obviously contemplates the existence of "capital assets" that are business-connected. The legislative history, furthermore, shows that Congress meant what it said in defining "capital asset" to include all property other than property specifically excepted in the statute.

Third, this Court's decision in *Corn Products* does not support petitioner's contention. The Court there construed the provisions of the predecessor of Section 1221 and found that the property in question fell within one of the enumerated exceptions. The Court did not purport to create a new judicial exception to the words of the statute.

Finally, as the existing confusion in the lower courts suggests, the rule advanced by petitioner would produce an amorphous, ill-defined category of non-capital assets that is not amenable to consistent

judicial application. By making the definition of "capital asset" depend on the "subjective motivations of taxpayers" (Pet. Br. 12), which are quite difficult for a court to ascertain, petitioner's rule in practical effect would allow taxpayers to wait and see what tax treatment will be most favorable, and then decide for themselves, depending on whether they have a gain or loss, whether they prefer the asset to be treated as capital or ordinary. In short, petitioner's contention is untenable; the court of appeals correctly held that the definition of "capital asset" is that expressly formulated by Congress in Section 1221 of the Code.

ARGUMENT

ALL OF PETITIONER'S SHARES OF BANK STOCK SOLD IN 1975 WERE "CAPITAL ASSETS," AND THE RESULTING LOSS WAS THEREFORE A CAPITAL LOSS

A. *The Express Terms Of Section 1221 Unequivocally Require That Petitioner's Loss Be Treated As A Capital Loss*

1. The statutory framework that governs this case is not complicated. Section 165(a) of the Code allows as a deduction from gross income "any loss sustained during the taxable year and not compensated for by insurance or otherwise." This provision is qualified by Section 165(f), which provides that "[l]osses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212." Section 1211(a) provides: "In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges." Section 1212(a) establishes rules governing carryback and carryforward of capital losses, permitting them to be offset against capital gains in certain earlier or later years.

It is apparent from this statutory framework that the question whether the loss suffered by petitioner on the sale of the Bank stock was a "capital" loss, subject to the limitations of Sections 1211 and 1212, turns entirely on whether those shares were "capital assets" within the meaning of Section 165(f). That term is explicitly defined in Section 1221. It sets forth the general rule that, "[f]or purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business)." Section 1221 then goes on to state that "the term 'capital asset' * * * does not include" property that falls within five specific exceptions. These exceptions cover, among other things, "property of a kind which would properly be included in the inventory of the taxpayer" (§ 1221 (1)); real property or other depreciable property used in the taxpayer's trade or business (§ 1221(2)); and "accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1)" (§ 1221(4)).[8]

Petitioner does not dispute that its Bank stock falls within the body of the Section 1221 definition, *i.e.*,

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[8] The present version of Section 1221 is set forth in its entirety at pages 1-3, *supra*. The version in effect in 1975, when petitioner sold its Bank stock, contained a different exception (5), relating to certain federal and state debt obligations issued on a discount basis. See 26 U.S.C. (1970 ed.) 1221(5). That exception was repealed by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 505(a), 95 Stat. 331. The present exception (5), relating to certain publications of the United States Government, was added by the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2132(a), 90 Stat. 1925. None of these changes, obviously, has any bearing on the question presented here.

that the Bank stock was "property held by the taxpayer (whether or not connected with his trade or business)." By the same token, petitioner has never claimed, and could not plausibly claim, that the Bank stock is covered by any of the enumerated statutory exceptions. The plain language of the statute thus makes it clear that all of petitioner's Bank stock was a "capital asset," and hence that the entire loss suffered by petitioner upon the sale of the shares in 1975 was a "capital loss." Absent some compelling reason for reaching a contrary conclusion, such unambiguous statutory language should be dispositive. See, *e.g.*, *Randall* v. *Loftsgaarden*, No. 85-519 (July 2, 1986), slip op. 8; *United States* v. *Turkette*, 452 U.S. 576, 580 (1981).[9]

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[9] Petitioner's discussion of the text of Section 1221 is limited to a single footnote. See Pet. Br. 17 n.9. Petitioner there suggests that the five exceptions listed in Section 1221 are merely illustrative of the types of property excluded from the general definition of capital asset, not an exhaustive list of such property. Petitioner invokes in support of this proposition Section 7701(c) of the Code, which provides that "[t]he terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined." But Section 7701(c), which sets forth a common-sense rule of statutory construction, is completely irrelevant here. Section 1221 does not state that the category of non-capital assets "includes" the five classes of property specified therein; if it did, Section 7701(c) would be relevant. To the contrary, Section 1221 states that capital asset "means" all property, but "does not include" the five classes of property listed as exceptions. The natural reading of such a statute is that the body of Section 1221 establishes an "exclusive definition" (*Groman* v. *Commissioner*, 302 U.S. 82, 86 (1937)), and that the phrase "but does not include" takes out of that all-encompassing definition only what is specifically mentioned, no more and no less. For example, if a statute provided that "the term 'protected spe-

2. Although petitioner does not try to anchor its argument in the text of Section 1221, it contends that one must look beyond the statutory language to effectuate the intent of Congress. Petitioner asserts that Congress's intent in enacting Section 1221 was "to distinguish between assets acquired and held in connection with the taxpayer's usual trade or business and those acquired principally for investment" (Br. 11), or, alternatively, "to distinguish between transactions related to everyday business operations and transactions which are 'not the normal source of business income' " (Br. 20 (citation omitted)). The language of the statute, however, unmistakably defeats this contention. The words that Congress chose make it clear that Congress did *not* intend the definition of "capital asset" to turn on the distinction between "business" assets or transactions and "investment" assets or transactions.

Putting aside for the moment the five specific exceptions, the basic definition of "capital asset" contained in Section 1221 is "property held by the taxpayer (*whether or not connected with his trade or business*)" (emphasis added). The parenthetical clause serves no purpose other than to dispel the very contention that petitioner is making. That clause expressly makes the business purpose underlying the acquisition or use of an asset *irrelevant* in determining whether it is covered by the general definition. The existence of a business nexus, of course, will often be relevant in determining whether a particular asset is covered by one of the five listed exceptions, since those exceptions speak of "stock in trade," depreciable

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cies' means all animals but does not include dogs," it could not seriously be contended that the definition should be read to exclude cats as well as dogs.

property and real property "used in [the taxpayer's] trade or business," and of accounts or notes receivable "acquired in the ordinary course of [his] trade or business" (I.R.C. § 1221(1), (2), and (4)). But petitioner does not contend that any of the listed exceptions covers its Bank shares, and the existence vel non of a business connection is thus irrelevant in this case.

As this Court has noted, "[t]he 'plain purpose' of legislation * * * is determined in the first instance with reference to the plain language of the statute itself." *Board of Governors of the Fed. Reserve System* v. *Dimension Financial Corp.*, No. 84-1274 (Jan. 22, 1986), slip op. 12. Under this principle, the parenthetical clause in Section 1221 completely refutes petitioner's contention about the supposed intent of Congress. We can accept arguendo the truth of petitioner's assertion (see Br. 34) that the process of drafting legislation is sufficiently imperfect that statutes will often need judicial refinement to mirror congressional intent accurately. But petitioner is not seeking refinement here, it is seeking a complete redrafting of the statute. If Congress truly intended the definition of "capital asset" to exclude all property acquired or used for a business purpose, it is inconceivable that Congress would have defined "capital asset" to mean all property "whether or not connected with [a] trade or business." That clause, obviously, contemplates that *some* property connected with a trade or business can be a capital asset, and it thus negates in the clearest language imaginable the congressional intent hypothesized by petitioner.

3. The legislative history of Section 1221, to which petitioner makes no reference, confirms that Congress did not intend the definition of "capital asset" to turn on the existence vel non of a dominant business mo-

tive for an asset's acquisition or use. The body of the statutory definition, including the parenthetical clause, has remained unchanged in any fashion relevant here since its enactment in 1924. See Revenue Act of 1924, ch. 234, § 208(a)(8), 43 Stat. 263.[10] At that time, the only exception to the definition of "capital asset" was the exception for inventory and stock-in-trade, which closely resembled that now set forth in Section 1221(1).[11] Congress subsequently added other exceptions, some of which, like the inventory exception, were designed to cover business-related assets. In 1938, for example, Congress added an exception for depreciable property used in a trade or business, an exception corresponding to that now contained in Section 1221(2). See Revenue Act of 1938,

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[10] Prior to 1924, the definition provided that "[t]he term 'capital assets' * * * means property acquired and held by the taxpayer *for profit or investment* for more than two years (whether or not connected with his trade or business), *but does not include property held for the personal use or consumption of the taxpayer or his family* * * *." Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (emphasis added). The italicized language was deleted in 1924. The effect of those deletions was to expand the category of "capital assets" to include personal items not necessarily held for profit, such as a taxpayer's personal residence. Thus, the statutory definition in 1921 did contain a distinction between for-profit and investment use, on the one hand, and personal use, on the other. Contrary to the statement of Amicus Kraft Co. (Br. 11-14), however, the definition has *never* contained a distinction between investment use and business use.

[11] The final clause of the inventory exception was amended in the Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 714, by adding the phrase "to customers" to modify "sale," and by adding the word "ordinary" to modify "course of his trade or business."

ch. 289, § 117(a)(1), 52 Stat. 500. In 1942, Congress amended that exception to include real property used in a trade or business. Revenue Act of 1942, ch. 619, § 151(a), 56 Stat. 846. The exception for certain accounts or notes receivable "acquired in the ordinary course of trade or business," now set forth in Section 1221(4), was added by the Internal Revenue Code of 1954, 68A Stat. 322.[12]

The manner in which Section 1221 has evolved clearly shows that it cannot be read to embody a universal exception for all business-related assets. Rather, Congress has amended the statute on several occasions to remove specified categories of business-related assets from the general definition. These specific amendments, of course, would have been entirely unnecessary if the statute had always incorporated the universal exception that petitioner posits. Each time Congress has amended the statute, moreover, it has restricted its action to enacting the enumerated exception, leaving intact the parenthetical clause stating that property, unless specifically excepted, is a capital asset "whether or not connected with [the taxpayer's] trade or business." Thus, although the statute in its present form contains specific exceptions that remove many, and perhaps most, business-related assets other than stock and securities from the body of the definition, the parenthetical clause obviously retains its vitality for property not covered by those exceptions. There is absolutely no

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[12] The third exception, covering copyrights, musical compositions, and other intellectual property, was added in 1950. Revenue Act of 1950, ch. 994, § 210(a), 64 Stat. 932. The current fifth exception was added in 1976. See note 8, *supra*. Its predecessor, repealed in 1981, had been added by the Revenue Act of 1941, ch. 412, § 115(b), 55 Stat. 698.

reason to believe that Congress intended stock like that sold by petitioner in 1975 to be treated as other than a "capital asset," whether or not its acquisition was motivated by a business purpose.

The indicia of congressional intent outside the statute's text also demonstrate the unsoundness of petitioner's contention. When Congress was considering the first definition of "capital assets" in 1921, a question arose on the Senate floor whether there would be a distinction between a capital transaction that takes place "as a part of the [taxpayer's] business" and one that does not. 61 Cong. Rec. 5836 (1921) (Sen. King). The reply given by Senator McCumber, a member of the Senate Finance Committee, was that the only distinctions were those made in the statute's text, which provided an exception for business property of the type that would be included in inventory, as well as an exception (repealed in 1924) covering property held for the taxpayer's personal use. See Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233. "Nothing further than what is contained" in the statute was intended to be a ground for exclusion from the statutory definition. 61 Cong. Rec. 5836-5837 (1921) (Sen. McCumber).

The congressional reports accompanying the Revenue Act of 1934 reiterated that the exceptions to the general definition of "capital asset" were limited to those specified in the statute. That Act amended the definition of "capital asset" to remove a holding-period limitation contained in previous laws, and instead made the taxpayer's holding period relevant only in determining whether his capital loss on the asset's sale would be short-term or long-term.[19] The

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[19] Between 1921 and 1934, "capital assets" had been defined to mean property that was "held by the taxpayer for

discussion of that amendment in the House report stated (H.R. Rep. 704, 73d Cong., 2d Sess. 31 (1934) (emphasis added)):

> The following propositions are essential to the consideration of the new treatment:
>
> * * * * *
>
> (4) Subsection (b) defines capital assets. *It will be noted that the definition includes all property, except as specifically excluded.*

The Senate report stated that it "concur[red] in the general features of the plan proposed by the House bill, but believe[d] a few modifications should be made therein." S. Rep. 558, 73d Cong., 2d Sess. 12 (1934).[14] The congressional reports accompanying the enactment of the Internal Revenue Code of 1954 similarly stated that Section 1221 was derived from Section 117(a)(1) of the 1939 Code, which provided

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more than two years." See, *e.g.*, Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233; Revenue Act of 1924, ch. 234, § 208(a)(8) and (b), 43 Stat. 263; Revenue Act of 1932, ch. 209, § 101(a) and (c)(8), 47 Stat. 191, 192.

[14] The most notable modification was the amendment to the "inventory" exception discussed briefly in note 11, *supra*. In order "to prevent tax avoidance" (S. Rep. 558, 73d Cong., 2d Sess. 12 (1934)), Congress changed the language of that exception to specify that it covered only property "held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business" (emphasis added). The purpose of adding the italicized words was to ensure that securities bought and sold by a "trader," *i.e*, someone trading for his own account, would be treated as capital assets. Securities bought and sold by a "dealer," by contrast, would continue to fall within the inventory exception to the definition of "capital asset." See H.R. Conf. Rep. 1385, 73d Cong., 2d Sess. 22 (1934); 4 J. Mertens, *Law of Federal Income Taxation* § 22.13, at 102 (1980).

that "a capital asset is property held by the taxpayer with certain exceptions." H.R. Rep. 1337, 83d Cong., 2d Sess. A273 (1954); S. Rep. 1622, 83d Cong., 2d Sess. 431 (1954).[15]

Congress's repeated admonitions that exceptions to the definition of "capital asset" are limited to those statutorily specified were embodied in Treasury Regulations issued under the 1934 Act. Article 117-1 of Regulations 86 provided that "[t]he term 'capital assets' includes all classes of property not specifically excluded by section 117(b)." That statement in the Regulations has remained substantially unchanged for more than 50 years, and it appears today at Treas. Reg. § 1.1221-1(a). In sum, there is simply no basis for divining a congressional intent that a general business-connection exception should be engrafted onto the definition of "capital asset" set forth in Section 1221.[16]

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[15] It bears mentioning that the Revenue Act of 1942, ch. 619, § 123(a)(1), 56 Stat. 820, added Section 23(g)(4) of the 1939 Code, the predecessor of the current Section 165(g)(3). Section 165(g)(3) provides that when stock of a 80%-owned subsidiary (formerly, a 95%-owned subsidiary) engaged in active business becomes worthless, the stock of the subsidiary shall not be treated as a capital asset. The enactment of this provision is difficult to square with petitioner's contention. Obviously, this provision contemplates that capital-asset treatment will continue to govern *sales* of stock in a subsidiary, as well as situations where a subsidiary's stock becomes worthless, yet the parent's percentage ownership is smaller than that specified in Section 165(g)(3). Under petitioner's view, these limitations would evaporate as long as the acquisition of the subsidiary's stock was business-connected.

[16] Although petitioner cites no direct evidence concerning the intent of the Congress that enacted Section 1221, it does assert (Br. 35-40) that Congress's failure to amend that Sec-

B. *This Court's* Corn Products *Decision Did Not Create An Extra-Statutory Exception To The Specific Terms Of Section 1221*

Eschewing any reliance on the language of Section 1221 or its legislative history, petitioner rests its entire argument on what it calls "the *Corn Products* doctrine." Petitioner refers to a series of lower-court decisions, beginning with *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (Ct. Cl. 1962), that have purported to apply this Court's opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955). The lower courts, apart from the court of appeals below, have read that opinion to suggest that

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tion in later years, so as to overturn the lower-court decisions following in the wake of the Court of Claims' 1962 decision in *Booth Newspapers*, demonstrates that those decisions must have correctly identified the original intent of Congress. As this Court had noted on many occasions, however, "unsuccessful attempts at legislation are not the best of guides to legislative intent." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381-382 n.11 (1969). See also *Milwaukee* v. *Illinois*, 451 U.S. 304, 332 n.24 (1981); *Bryant* v. *Yellen*, 447 U.S. 352, 376 (1980). Thus, even when the terms of a statute are ambiguous, subsequent congressional inaction is an unreliable guide to the intention of its original drafters; that conclusion follows *a fortiori* where, as here, the terms of the statute are perfectly plain. Petitioner's "congressional acquiescence" argument, moreover, is particularly inapt in the present context, since the lower courts are in complete disarray about the scope of the supposed judicial exception to Section 1221. See pages 36-40, *infra*. Congress surely has not "recognized and approved" (Pet. Br. 35) *all* of these lower-court interpretations, which are mutually inconsistent. Rather than choosing some lower court decision to represent the governing rule on the theory that Congress approved that decision through inaction, the correct method of statutory interpretation is to focus on the text of the statute and the intent of the Congress that enacted it.

the terms of Section 1221 do not exclusively control whether an asset is a "capital asset," and that there exists a broad exception to the statutory definition in addition to the exceptions statutorily specified. Under this so-called "*Corn Products* doctrine," the characterization as a capital asset of property, including capital stock, is said to turn on the extent to which the taxpayer's acquisition of the property had a "business" rather than an "investment" purpose.

We agree with the court of appeals that this line of lower-court decisions is "misbegotten" (Pet. App. A10). This Court in *Corn Products* did not authorize an open-ended judicial inquiry, divorced from the text of Section 1221, into whether property is a "capital asset." Rather, it simply construed the statute, giving a broad reading to one of the explicit statutory exceptions. A careful examination of the *Corn Products* case shows that this Court's opinion cannot be read "as either requiring or permitting the courts to decide that capital stock [not held by a dealer] can be anything other than a capital asset under section 1221." Pet. App. A10.

Corn Products Refining Co. (the taxpayer) was a nationally known manufacturer of starch, sugar and other products derived from grain corn. Most of its products were sold under contracts specifying a fixed price, or the market price on the date of delivery, whichever was lower (350 U.S. at 48). It had a storage capacity of barely three weeks' supply of raw corn. In 1934 and 1936, when droughts had caused sharp increases in the price of spot corn, the taxpayer had suffered from unanticipated increases in the cost of raw materials. To avoid a recurrence of this problem, the taxpayer "began to establish a long position in corn futures 'as a part of its corn buying program'

and 'as the most economical method of obtaining an adequate supply of raw corn' without entailing the expenditure of large sums for additional storage facilities" (*ibid.*).

When prices appeared favorable at harvest time, the taxpayer would establish a long position in corn futures so as to assure an adequate supply of raw corn at a stable price. The taxpayer would take delivery on such futures contracts as it found necessary for its manufacturing operations, and it would sell off the rest of the futures contracts in early summer if no shortage appeared imminent. If shortages appeared, however, it sold off the futures contracts only as it bought spot corn for grinding. 350 U.S. at 48-49. In 1940, the taxpayer netted a profit of approximately $681,000 from futures transactions, which it treated as a reduction in the cost of raw materials (see 16 T.C. 395, 398 (1951)). In 1942, the taxpayer had a loss of approximately $110,000 from futures transactions, which it treated as an addition to cost of goods sold (see 11 T.C.M. (CCH) 721, 723-724 (1952)). "In computing its tax liability, Corn Products reported these figures as ordinary profit and loss from the manufacturing operations for the respective years" (350 U.S. at 49).

After the Commissioner had asserted tax deficiencies for 1940 and 1942 on unrelated grounds, the taxpayer filed petitions in the Tax Court, where it argued for the first time that its futures contracts were "capital assets" whose sale gave rise to capital gains and losses. The Tax Court decided the 1940 case against the taxpayer on other grounds (16 T.C. 395 (1951)). In the 1942 case, the Tax Court held that the taxpayer on its tax return had correctly treated the futures transactions as "hedges" giving

rise to an ordinary loss, rather than "speculative transactions of a capital nature" (11 T.C.M. at 726).

On consolidated appeals, the Second Circuit affirmed (215 F.2d 513 (1954)). It held that the taxpayer's futures transactions were "hedging" transactions that fell within a specified exception to the definition of "capital asset" contained in Section 117(a)(1) of the 1939 Code. That definition read in pertinent part as follows: "The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year * * *." Internal Revenue Code of 1939, ch. 1, § 117(a)(1), 53 Stat. 50.

The Second Circuit began by explaining why hedging transactions in futures contracts, as opposed to "legitimate capital transactions," came within the inventory exception set forth in Section 117(a). The court stated that a "hedge" is "part of the inventory purchase system which is utilized solely for the purpose of stabilizing inventory cost. It is an integral part of the productive process * * * [that] cannot reasonably be separated from the inventory items." The court concluded: "The tax treatment of hedges, then, is not a 'judge-made exception' to Section 117(a); it is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section." 215 F.2d at 516.

With this principle in mind, the court went on to address the particular facts of the *Corn Products* case. The court acknowledged that, because the taxpayer in its futures transactions sought to protect itself only from inventory price increases and not

from price declines, those transactions "did not constitute what is known as 'true' hedging" (215 F.2d at 516).[17] The court concluded, however, that the distinction between a "true hedge" and the type of hedge used by the taxpayer in *Corn Products* was not significant in determining whether the futures contracts represented capital assets. The court explained (*ibid.*):

> The property here was used for essentially the same purpose and in the same manner as in true hedging. Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether complete or only partial insurance was thereby obtained is simply a difference in degree, not in kind. Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117(a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.

Thus, the court concluded that the taxpayer's transactions in corn futures fell within the inventory exception to the statutory definition of "capital assets."

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[17] In G.C.M. 17322, XV-2 C. B. 151-152 (1936), the Treasury Department had issued an opinion as to "whether losses from hedging futures transactions on commodity exchanges constitute 'capital losses.'" The Department concluded that "hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets," and it gave examples of "true hedges against price fluctuations in spot goods" (*id.* at 155; see *id.* at 152). The results of such transactions were to be reflected in inventory adjustments (*id.* at 153). In view of the analysis adopted in the Treasury opinion, courts at the time generally sought to determine whether futures contracts were "capital assets" by inquiring whether they represented "true hedges." See, *e.g.*, *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F.2d 772, 774-775 (5th Cir. 1941); *Grote* v. *Commissioner*, 41 B.T.A. 247, 249 (1940).

This Court granted the taxpayer's petition for certiorari and affirmed.[18] In so doing, the Court resolved the following question presented in the petition (see 350 U.S. at 47 n.2):

> Are transactions in commodity futures which are not "true hedges" capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions?

There is language in the Court's opinion stating that profits and losses from everyday business operations generally will not be "capital" in nature, and it is this language that the lower courts have invoked to justify the so-called "*Corn Products* doctrine." But a careful examination of the opinion as a whole shows that the Court simply gave a broad reading to the exceptions set forth in the statute itself, and that it adopted the court of appeals' rationale that the taxpayer's futures transactions were "hedges" that fell within the inventory exception to the statutory definition of "capital asset."[19]

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[18] The Court noted that the taxpayer had asserted a conflict in the circuits (350 U.S. at 47). Each of the decisions that the Court cited (*id.* at 47 n.3) involved the narrow question whether hedging futures transactions on commodity exchanges were transactions in "capital assets." See *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F.2d 33 (6th Cir. 1945); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F.2d 772 (5th Cir. 1941); *Makransky's Estate* v. *Commissioner*, 154 F.2d 59 (3d Cir. 1946) (per curiam).

[19] It cannot seriously be disputed that there was no need for this Court in *Corn Products* to go beyond interpreting the specific exceptions in the statute in order to affirm the

The Court first discussed the purpose of the taxpayer's futures transactions. It recited the lower courts' findings that those transactions were "designed to protect [the taxpayer's] manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements" (350 U.S. at 50). The Court further observed that "it appears that the transactions were vitally important to the company's business as a form of insurance against increases in the price of raw corn" and that "the purchase of corn futures assured the company a source of supply which was admittedly cheaper than constructing additional storage facilities for raw corn" (*ibid.*). "[I]t is difficult to imagine," the Court said, "a program more closely geared to a company's manufacturing enterprise or more important to its successful operation" (*ibid.*).

In response to the taxpayer's "labeling its activity as that of a 'legitimate capitalist' exercising 'good judgment' in the futures market," the Court stated

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judgment of the court of appeals. Even those who view *Corn Products* as creating a novel judicial exception to the statute recognize that the inventory exception provided an adequate basis for decision. See, *e.g.*, 2 B. Bittker, *Federal Taxation of Income, Estates, and Gifts* ¶ 51.10.3, at 51-62 (1981) (approving "*Corn Products* doctrine," but noting that this Court's decision in that case "could have been reached with less strain by a narrower alternative rationale"); Kraft Co. Amicus Br. 3. The "*Corn Products* doctrine" thus rests on the dubious assumption that the Court deliberately adopted a broad rationale unnecessary to its decision in order to create a judicial exception to Section 1221; as we shall show, that assumption cannot stand in the face of what the Court actually said in *Corn Products* about the rationale of its holding.

that this characterization "ignore[d] the testimony of its own officers" (350 U.S. at 51). Those individuals had testified that "in entering [the futures] market the company was 'trying to protect a part of [its] manufacturing costs' " and "to fill an actual 'need for the quantity of corn [bought]' " in order to cover the products it expected to market (*ibid.*). The Court likewise dismissed as irrelevant the taxpayer's assertion "that its transactions did not constitute 'true hedging.' " "It is true," the Court explained, "that Corn Products did not secure complete protection from its market operations. • • • It is clear, however, that [it] feared the possibility of a price rise more than that of a price decline. It therefore purchased partial insurance against its principal risk, and hoped to retain sufficient flexibility to avoid serious losses on a declining market" (*ibid.*).

Having thus examined the function and significance of the taxpayer's market operations, the Court turned to the ultimate question in the case—whether the hedging contracts were "capital assets" under the statutory definition of that term. The Court introduced the central paragraph of its opinion as follows (350 U.S. at 51): "Nor can we find support for petitioner's contention that hedging is not within the exclusions of § 117(a)." The Court admitted that the futures did not "come within the literal language of the exclusions set out in that section" because they "were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business" (*id.* at 51-52). The Court noted some of the purposes underlying the capital-asset provisions, including the grant of preferential treatment to transactions that "are not the normal source of business income"; it also noted that

"Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss" (*ibid.*). The court concluded (*id.* at 52): "Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." [20]

The Court first pointed out that the body of the definition of capital asset—"property held by the taxpayer (whether or not connected with his trade or business)"—had been given a narrow reading in cases involving contract claims or rights to what would be ordinary income, thereby preventing taxpayers from converting ordinary income into preferentially taxed capital gains. See 350 U.S. at 52 (citing *Kieselbach* v. *Commissioner*, 317 U.S. 399, 403 (1943)) (interest portion of lump-sum condemnation award); *Hort* v. *Commissioner*, 313 U.S. 28, 31 (1941) (unexpired lease). See also *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U.S. 130, 134-136 (1960) (claim for the fair rental value of property is not itself "property" within the meaning of former Section 117(a)). The Court therefore concluded that, while "property" should be construed narrowly, the

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[20] Petitioner quotes all but the opening sentence of the Court's discussion on this point (Pet. Br. 16-17). But to omit the opening sentence, which explicitly states that the taxpayer's hedging transactions were "within the exclusions of § 117(a)," inaccurately shifts the focus of the Court's discussion away from the text of the statute. See also, *e.g.*, 2 B. Bittker, *Federal Taxation of Income, Estates, and Gifts* ¶ 51.10.3, at 51-62 (1981) (making the same mistake); *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694, 707 (1976) (same). Viewed in its entirety, the Court's discussion clearly focused on interpreting the specific exceptions in the statute.

statutory exclusions from the definition of "capital asset" had to be interpreted broadly in order "to effectuate the basic congressional purpose" (350 U.S. at 52).

The Court then explained that the established treatment of "hedging" transactions required that the statutory exclusions be interpreted broadly enough to embrace commodity futures employed for that purpose. The Court noted that the Treasury Department, in G.C.M. 17322, XV-2 C. B. 151 (1936), had concluded that "hedging transactions were essentially to be regarded as insurance rather than a dealing in capital assets," and hence that "gains and losses therefrom were ordinary business gains and losses" (350 U.S. at 52); in that same ruling, the Treasury had concluded that a manufacturer's raw material inventory should be adjusted to reflect futures contracts employed for hedging (XV-2 C. B. at 153, 154-155). The Court noted that the Treasury ruling "had been consistently followed by the courts as well as by the Commissioner" for almost 20 years and was solidly entrenched (350 U.S. at 53). And the Court pointed out that, in Section 1233(a) of the 1954 Code, which had just recently been enacted, Congress had explicitly recognized that bona fide hedging transactions in commodity futures "do not result in capital gains or losses" (350 U.S. at 53 & n.9).

The Court's ultimate conclusion in *Corn Products* left little doubt as to the scope of its holding. It ruled "that *the statute* clearly refutes the [taxpayer's] contention" (350 U.S. at 53 (emphasis added)).[21] In af-

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[21] The Court added that "practical considerations lead to the same conclusion" (350 U.S. at 53). If corn futures constituted capital assets, yet raw corn constituted inventory, which is not a capital asset, the Court explained that the

firming the Second Circuit, this Court's opinion in *Corn Products* is thus fully consistent with the lower court's statement that the tax treatment of hedges is not "a judge-made exception" to the predecessor of Section 1221, but a recognition "that property used in hedging transactions properly comes within the exclusions of the section" (215 F.2d at 516). Indeed, this Court explicitly rejected the idea that Section 1221's text is inadequate to its task in *Malat* v. *Riddell*, 383 U.S. 569, 572 (1966), where, after referring to the *Corn Products* opinion, it stated that "[a] literal reading of [Section 1221] is consistent with [its] legislative purpose." Nothing in *Corn Products* casts any doubt on the Eighth Circuit's conclusion in this case that, in light of Congress's failure "to incorporate some sort of exception regarding capital stock" in Section 1221, "the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make" (Pet. App. A10).[22]

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hedger could choose capital or ordinary tax treatment at will. He could either sell the futures and purchase in the spot market, thus getting capital treatment; or he could take delivery under the futures contract, thus getting ordinary treatment. In the words of the Court, such a state of affairs would create a "loophole" that would "frustrate[]" the congressional purpose (*id.* at 54). Similar considerations led Congress in 1954 to provide explicitly in Section 1234 that, for purposes of capital gain and loss, an option should have the same character as the property to which the option relates. See H.R. Rep. 1337, 83d Cong., 2d Sess. A278-A279 (1954); S. Rep. 1622, 83d Cong., 2d Sess. 437-438 (1954).

[22] Petitioner errs in asserting (Br. 15-16) that the theory it urges here is the position that was advanced in the government's brief in *Corn Products*. In arguing that the "exclusions from the capital asset definition [should] be broadly applied" to cover transactions in corn futures (Gov't Br.

C. *The Test Petitioner Seeks To Apply For Determining Whether Property Is A "Capital Asset" Is Illogical And Unworkable*

Petitioner contends that the status of an asset as a "capital asset" should not be governed by Section 1221, but rather should be governed by the "*Corn Products* doctrine" that has been developed by the lower courts. One of the many problems with this contention is that there is no single identifiable "*Corn Products* doctrine." Rather, the lower courts are in considerable disarray on this issue, and the "doctrine" is little more than an amorphous collection of decisions that have repeatedly changed the applicable test, usually with a view to expanding the circumstances under which capital stock can be excluded from the definition of a "capital asset." See generally 2 B. Bittker, *supra*, § 51.10.3, at 51-61; Note, *The Corn Products Doctrine and Its Application To Partnership Interests*, 79 Colum. L. Rev. 341 (1979); Troxell & Noall, *Judicial Erosion of the Concept of Securities as*

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at 12, *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955)), the government did argue that the hedging transactions had to be analyzed in the context of the taxpayer's manufacturing business. And the brief did contain broad language describing Congress's general intent to except from the capital-asset definition certain everyday business expenses. But the brief recognized (*id.* at 17) that the relevant inquiry was "the proper construction to be given to Code Section 117," and the thrust of the brief was to defend the court of appeals' holding that hedging transactions designed to assure an adequate supply of inventory fall within the first statutory exception to the definition of "capital asset." The government's brief did not urge, as does petitioner, that the statutory definition can be ignored in favor of a judicially-created doctrine that relies on an extra-statutory distinction between "business" assets and "investment" assets.

Capital Assets, 19 Tax L. Rev. 185 (1964). This frolic by the lower courts has led to many decisions that "possibly might surprise the *Corn Products* [C]ourt." *Agway, Inc.* v. *United States*, 524 F.2d 1194, 1200 (Ct. Cl. 1975). In our view, none of the various formulations of the "*Corn Products* doctrine" should supplant the statutory definition that Congress adopted.

1. The line of lower-court cases upon which petitioner relies begins with *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (Ct. Cl. 1962). In that case, two newspapers bought all of the stock of a paper company in order to assure an adequate supply of newsprint in a time of shortage, and they sold the stock at a loss several years later when the shortage had eased. The Court of Claims brushed aside Section 1221's definition of capital asset as "an elastic concept" (303 F.2d at 920) and permitted an ordinary-loss deduction on the sale of the stock. The test formulated by the Court of Claims allowed ordinary-loss treatment in the case of any securities "purchased by a taxpayer as an integral and necessary act in the conduct of his business," as opposed to securities whose purchase was motivated by "an investment purpose" (*id.* at 921).

As might be expected from a doctrine so divorced from any statutory foundation, the rule announced in *Booth Newspapers* has continued to expand and change shape as different courts have tinkered with it. The possibility that the departure from Section 1221 might be confined to cases where the stock in question was acquired to help guarantee a source of supply soon evaporated, and "the *Corn Products* doctrine" at that point ceased to bear any sensible rela-

tionship to the *Corn Products* case.[23] The new doctrine was applied to afford ordinary-loss treatment on the sale of stock acquired by an individual to assure employment (*Steadman* v. *Commissioner*, 424 F.2d 1 (6th Cir.), cert. denied, 400 U.S. 869 (1970)), and on the sale of stock acquired by a corporate commission agency to assure an important account (*Waterman, Largen & Co.* v. *United States*, 419 F.2d 845 (Ct. Cl. 1969), cert. denied, 400 U.S. 869 (1970)). And the requirement enunciated in *Booth Newspapers*—that the stock acquisition be integral to an existing business—was substantially eroded when the "*Corn Products* doctrine" was invoked to allow an ordinary loss on the sale of stock acquired with the objective of expanding the taxpayer's existing busi-

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[23] A stock acquisition designed to ensure a source of supply of a necessary raw material, like that in *Booth Newspapers*, at least arguably bore some "conceptual nexus" to the facts of *Corn Products* itself. See *Waterman, Largen & Co.* v. *United States*, 419 F.2d 845, 860, (Ct. Cl. 1969), cert. denied, 400 U.S. 869 (1970) (Nichols, J., dissenting). But while such an equity investment could be viewed as relating to inventory, we do not believe that it would fall within even the broadest reading of the "inventory" exception contained in Section 1221(1). Stock that is held for several years cannot possibly be included in the annual adjustments that are the reason for inventory accounting, and such stock clearly is not "property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year" (I.R.C. § 1221(1)). The futures contracts at issue in *Corn Products*, moreover, represented no more than rights to obtain the raw material and could "easily be viewed as surrogates for the raw material itself" (2 B. Bittker, *supra*, ¶ 51.10.3, at 51-62). Shares of stock, by contrast, represent a bundle of rights associated with ownership of a company, some of which have no connection to maintaining an inventory of a particular raw material.

ness into a new area (*Schlumberger Technology Corp.* v. *United States*, 443 F.2d 1115 (5th Cir. 1971)).

The courts are also in disarray with respect to the *motive* that must underlie an acquisition of stock in order for the sale of that stock to generate an ordinary loss. Some courts have been satisfied as long as there is a dominant business purpose for the acquisition; such a motive has been found to exist, and has been held sufficient to make stock a non-capital asset, where the shares had been held for 44 years. See *Union Pacific R.R.* v. *United States*, 524 F.2d 1343 (Ct. Cl. 1975), cert. denied, 429 U.S. 827 (1976). But the existence of a business motivation—usually, but not invariably, determined on a subjective basis [24]—has not always been thought to be enough. The Tax Court, seeking to avoid the need to measure and compare different motives, has held in a reviewed decision that any substantial investment motive for acquiring an asset would cause it to be treated as a "capital asset," even if the taxpayer could show a dominant business motive. *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694 (1976), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977). The Fourth Circuit has taken the same approach. *Wright* v. *Commissioner*, 756 F.2d 1039 (1985). Most recently, some courts, including the Tax Court in this case (Pet. App. B20-B21), have stated that any stock acquisition motivated by the purpose of protecting one's business reputation falls within the "*Corn Products* doctrine." Thus, where a taxpayer initially agreed to purchase stock in a foreign company as an

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[24] See *Agway, Inc.* v. *United States*, 524 F.2d at 1204 (suggesting that motive must be determined by examination of objective indicia).

investment, and later went ahead with the purchase even though it had since learned that the acquired company had severe financial difficulties, the stock was held to be a non-capital asset on the theory that failing to go through with the deal would have harmed the purchaser's business reputation as a supposedly astute investor. *Campbell Taggart, Inc.* v. *United States*, 744 F.2d 442, 451 (5th Cir. 1984).[25]

Regardless of its particular formulation, the "*Corn Products* doctrine" developed by the lower courts presents numerous difficulties. First and foremost, as discussed earlier, it requires that the statutory definition of "capital asset" be completely ignored. Instead, it establishes an array of tests for determining whether property is a "capital asset"—tests that are fundamentally at odds with the import of the parenthetical clause in Section 1221, which has remained in the statute undisturbed for 60 years. However the doctrine is articulated in a particular case, it is likely to produce non-capital-asset treatment in a variety of situations that bear no resemblance at all to *Corn Products* itself.

Second, "the *Corn Products* doctrine" illogically makes the capital-asset determination turn upon a false dichotomy. A "business purpose" and an "investment purpose" are ill-defined categories that are

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[25] After this Court, over dissents by Justices Harlan, Stewart and Blackmun, denied the government's petitions for certiorari in *Waterman* and *Steadman* (400 U.S. 869 (1970)), the Commissioner found it necessary to issue Revenue Rulings that reflected what appeared to be the then-prevailing body of opinion in the lower courts. See, *e.g.*, Rev. Rul. 75-13, 1975-1 C. B. 67 (dominant business motive), superseded by Rev. Rul. 78-94, 1978-1 C. B. 58 (stating that the Commissioner would follow *W.W. Windle Co.* v. *Commissioner, supra*).

not true alternatives. Clearly, both purposes may coexist in a given transaction.[26]

Third, the "*Corn Products* doctrine" turns on motives, which petitioner (Br. 12), following most of the decisions, suggests must be the *subjective* motivation of the taxpayer. The determination of such a motive is usually an "uncertain and difficult" task for the fact finder (*Woodward* v. *Commissioner*, 397 U.S. 572, 577 (1970)), particularly when two or more motives are present that must be weighed relative to

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[26] The commingling of "business" and "investment" purposes is perhaps most obvious in cases like *Campbell Taggart, Inc.* v. *United States*, 744 F.2d 442 (5th Cir. 1984), where stock was held to be a non-capital asset because it was acquired to protect the taxpayer's "business reputation." The taxpayer there was a holding company "whose sole activity [was] the acquisition of capital assets"; the court stated that expenses to protect corporate goodwill are deductible business expenses and concluded that the loss on the stock in question had been incurred "to protect [the taxpayer's] goodwill and reputation" as an acquirer of corporate securities (744 F.2d at 453-454). In such a situation, it is obviously impossible to segregate "business" from "investment" purposes. A holding company like the taxpayer in *Campbell Taggart*, or a conglomerate like the taxpayer here, is in the "business" of making "investments," and the business reputation it seeks to cultivate is that of an astute investor. That observation also points up the flaw in the reasoning of the Fifth Circuit in *Campbell Taggart* and of the Tax Court in this case. The fact that expenses relating to an asset are "business expenses" does not mean that the asset is therefore a non-capital asset. For example, if a taxpayer purchases property for use in a trade or business over a period of years, the cost cannot be deducted in full in the first year; rather, the deduction must be spread out over the useful life of the property, which is commonly referred to as "capitalizing" the cost. That has no bearing, however, on whether the property is a "capital asset"; the answer to that question is determined by Section 1221.

each other. And an inquiry into motives is particularly obscure in the case of corporate motives, since corporate action typically reflects decisions taken collectively by a number of individuals.

The result of a focus on subjective motive, moreover, is to make capital-asset treatment almost elective with the taxpayer. If the taxpayer has a gain and wishes to have his asset treated as a capital asset, there will be little basis for questioning his testimony that it was acquired primarily as an investment. Indeed, we are aware of no reported decision that has applied the "*Corn Products* doctrine" to require a taxpayer to report the *gain* from a sale of stock as an ordinary gain. On the other hand, if the taxpayer has a loss and wishes to have his asset treated as an ordinary asset, it may not be difficult for him to come up with a "business purpose" that will satisfy some variant of the "*Corn Products* doctrine." Thus, ironically, the doctrine developed by the lower courts in the name of *Corn Products* presents taxpayers with the opportunity to choose between ordinary and capital treatment—precisely the "loophole" that this Court in *Corn Products* was determined not to open (see 350 U.S. at 53-54).

The instant litigation well illustrates the uncertainty that the "*Corn Products* doctrine" has engendered. The doctrine is sufficiently open-ended that all of the following approaches to the sale of petitioner's 661,000 shares of Bank stock have emerged during this case: (1) petitioner initially, when it expected to make a profit on the sale of the Bank stock, believed, and so communicated to its stockholders, that all of the shares would be capital assets whose sale would give rise to capital gain (see Pet. App. B10); (2) when the Bank shares were in fact sold at a loss,

petitioner took the position that all of the shares were non-capital assets whose disposition gave rise to ordinary loss; (3) the Tax Court held that most of the shares acquired after the end of 1972 were ordinary assets, but that those acquired earlier were capital assets; (4) petitioner, on appeal, took the position that all of the shares acquired after July 30, 1971—the date of its divestment election—were ordinary assets; and (5) it is the government's view (see pages 46-47, *infra*), that, even under the "*Corn Products* doctrine," all of the shares should be categorized as capital assets. A doctrine as shapeless as this has "workability" (Pet. Br. 21) only in the sense that it can be easily manipulated, and it should be rejected in favor of the statutory language enacted by Congress.

2. From this amalgam of disparate approaches and tests, petitioner chooses the broadest formulation, and the one most favorable to it, as the theory that should be adopted by this Court as the true "*Corn Products* doctrine" (see Pet. Br. 43-48). Petitioner maintains that an asset should be "characterized as an ordinary, non-capital asset if the dominant or primary motive for its acquisition was business-related" (Br. 43). This theory presents in exaggerated form the conceptual difficulties, discussed above, that are common to all of the tributaries of the "*Corn Products* doctrine."

First, the clash between petitioner's version of the doctrine and the statutory language is particularly marked. The test proposed by petitioner would render most of the exceptions specified in Section 1221 entirely superfluous. If the mere existence of a primary business purpose for acquiring property suffices to take that property out of the definition of "capital asset," there was no need for Congress to have enacted

the specific exceptions for certain types of business property in Section 1221(1), (2), and (4). These types of property, on petitioner's theory, would already have been excluded by the general rule since their acquisition was business-related.

Second, petitioner's theory that its Bank stock was not a capital asset cannot be reconciled with an established line of authority governing the treatment of securities in another context. The courts have consistently held that a "trader"—one who buys and sells securities for his own account—is engaged in a "trade or business" within the meaning of the Internal Revenue Code. Just last Term the Court accorded this line of authority the express recognition that it had implicitly granted 50 years ago. See *Commissioner* v. *Groetzinger*, No. 85-1226 (Feb. 24, 1987), slip op. 5-6 & 11 n.13; *Snyder* v. *Commissioner*, 295 U.S. 134 (1935). It is also clear that the securities that a trader buys and sells are capital assets. See *Mirro-Dynamics Corp.* v. *United States*, 374 F.2d 14 (9th Cir.), cert. denied, 389 U.S. 896 (1967); *Commissioner* v. *Covington*, 120 F.2d 768 (5th Cir. 1941); *Adnee* v. *Commissioner*, 41 T.C. 40 (1963). Indeed, assuring that securities sold by a "trader" would be treated as capital assets, while securities sold by a "dealer" would be excluded under the inventory exception, was what prompted Congress to amend the inventory exception in 1934 to cover only "property held for sale *to customers* in the *ordinary* course of * * * trade or business" (emphasis added). See note 14, *supra*. This well-established structure, of course, is wholly inconsistent with petitioner's position here. If a trader is in a "trade or business," then the securities that he trades are surely acquired for a purpose related to that business. Hence, under peti-

tioner's view, those securities would presumably be non-capital assets, in defiance of the law as it actually exists.

3. In light of the chaos that has attended the lower courts' efforts to expound a judicial exception to the statutory definition of "capital asset," we believe it is important that this Court reaffirm the primacy of the specific definition provided by Congress in Section 1221.[27] The court of appeals correctly held that the

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[27] This is not to suggest that all of the decisions issued under the rubric of the "*Corn Products* doctrine" are equally misguided. Some cases that do not stray too far from the facts of *Corn Products* itself do not reach unreasonable results and theoretically could be followed without creating an amorphous doctrine like *Booth Newspapers* that quickly leads to untenable results. For example, *Western Wine & Liquor Co.* v. *Commissioner*, 18 T.C. 1090 (1952), seems to reflect the proposition that a short-term purchase of stock or other asset for the sole purpose of assuring an inventory supply should be treated the same as the corn futures in *Corn Products*—at least as long as the stock is held no longer than necessary to accomplish its business objective. See 18 T.C. at 1099. It may well be that, as a policy matter, it makes sense not to treat such a purchase as a capital transaction. In light of the total disarray that has descended upon the lower courts since *Booth Newspapers* established a judicial doctrine untethered to the statutory text, however, we believe that sensible administration of the tax laws requires future cases in this area to be resolved only by reference to the terms of the statute. We therefore believe that the statutory exception for "inventory" should not be expanded to include common stock—which, unlike a commodity futures contract, is not a surrogate for inventory—and we accordingly do not embrace the holding of *Western Wine*. See 18 T.C. at 1100 (Van Fossen, J., dissenting) (predicting that the divergence from the statutory language approved in *Western Wine* "will rise to plague the Court in future cases"). If it makes sense in policy terms to treat as an ordinary asset either common stock or another

statutory definition leaves no room for capital stock, other than stock held by a dealer, to be treated as anything but a "capital asset." We thus think it clear that, on the facts here, all of the shares sold by petitioner in 1975 were "capital assets" and that the loss on that sale was entirely a "capital loss." It should be noted, however, that even under the various formulations of the "*Corn Products* doctrine," which we urge the Court to reject, it is highly questionable whether any of petitioner's shares could be characterized as other than capital assets.

Nothing in the Tax Court's findings or in petitioner's brief provides any basis for concluding that petitioner has satisfied the *Booth Newspapers* requirement that the acquisition of the shares be "an integral and necessary act in the conduct of [its] existing business" (303 F.2d at 921). To the contrary, the Tax Court's findings show that the Bank was quite isolated from petitioner's existing businesses—furniture manufacturing, insurance, data processing and tire sales—and that the Bank, unlike petitioner's other subsidiaries, never interacted with it in synergistic fashion. See Pet. App. B7, B18-B19. Indeed, the Tax Court specifically stated that "[t]he bank was not an integral and necessary part of [petitioner's] business" (*id.* at B19).

Even under petitioner's version of the "*Corn Products* doctrine," which requires no more than a "dominant business motive" for a stock purchase, petitioner's argument on these facts is highly dubious. One of the primary motives identified by the Tax Court for petitioner's post-1972 acquisitions of Bank stock

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class of property used in a trade or business, Congress can act, as it did in 1938, 1942, and 1954, to add that specific class of business property to the list of statutory exceptions.

was that petitioner "was compelled to participate [in capital calls] if it wished to preserve its equity in the bank" (Pet. App. B10). If the shares in the Bank were originally purchased as an investment, as the Tax Court found that they were, it is not apparent why further purchases to protect or enhance that investment should be treated as having a business, rather than investment, purpose. In general, an asset acquired to preserve one's existing assets ought to assume the same character as the assets sought to be preserved—in this case, capital assets. Cf. *United States* v. *Generes*, 405 U.S. 93 (1972) (bad debt incurred to protect non-business investment is a non-business bad debt under Section 166(d)).[28] And, as noted earlier (see note 26, *supra*), even if the dominant motive for petitioner's acquisition of Bank stock was to preserve its business reputation (see Pet. App. B21), the fact that expenses to preserve goodwill may normally be deducted does not mean that stock acquired for that purpose is a non-capital asset.

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[28] Petitioner errs in invoking *Generes* (Br. 46-47) to support its contention that a "dominant motive test" should be employed to distinguish between business and non-business assets for purposes of Section 1221. The Court in *Generes* was required to distinguish between the business and non-business aspects of the taxpayer's investment because the statute involved there, covering bad-debt losses, explicitly distinguished between business and non-business bad debts. See I.R.C. § 166(d). If Section 1221 established a similar dichotomy between business and non-business assets, the aspect of *Generes* to which petitioner refers would be relevant. In fact, of course, Section 1221 does precisely the opposite; the parenthetical clause states that it makes no difference whether or not the asset is used in a trade or business.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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